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MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT & DEPUTY TO THE CHIEF OF STAFF
ASSISTANT TO THE PRESIDENT FOR CABINET AFFAIRS
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

SUBJECT Senior Interdepartmental Group on International Economic Policy

Attached are the minutes of the SIG-IEP meeting held on May 14, 1984.

Christopher Hicks
Executive Secretary and
Executive Assistant to the Secretary

Attachment

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DCI EXEC REG

SENIOR INTERDEPARTMENTAL GROUP-INTERNATIONAL ECONOMIC POLICY

May 14, 1984
2:00 p.m.
Roosevelt Room

Attendees:

Treasury
Secretary Regan, Chairman
David C. Mulford
Ronald E. Myers

State
W. Allen Wallis
Richard McCormack

Defense
Dou Zakheim
Mark Shwartz

Agriculture
Richard E. Lyng

Commerce
Lionel Olmer
Olin Wethington

CIA
Maurice Ernst
[redacted]

NSC
Roger Robinson
David Wigg

Cabinet Affairs
Larry Herbolsheimer

CEA
Geoffrey Carliner
Jeff Frankel

AID
Peter McPherson
Richard Derham

OVP
Lt. Col. Eckert

USTR
Robert Lighthizer 25X1
Harvey Bale

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Status Report on the International Debt Strategy

Chairman Regan indicated he called the meeting because of several developments over the last few weeks which have focused increased attention on the international debt situation. These included the current visit of the Mexican President, upcoming meetings of the OECD, G-10, Summit, a recent conference of bankers hosted by the New York Fed, and statements attributed by the press to some Administration officials raising questions about the debt strategy. These, plus the recent increases in interest rates, which have upset debtors, have fueled speculation the Administration may change its debt strategy.

Secretary Regan thought it was important to ensure that the United States position should not be misrepresented and that we should support the strategy in the run-up to the Summit. After hearing from our Allies at the Summit, a Working Group could look into the strategy and report to the SIG by the fall.

Secretary Regan personally doubted that there was a magic solution to the varied problems facing the many debtors and believed that the IMF centered strategy is a wise course. In any case, the IMF would not change its approach without U.S. prompting and probably international agreement. Secretary Regan noted that the G-77 effort to hold a monetary conference under the aegis of UNCTAD could serve as a vehicle for such agreement, if the independence of specialized agencies are guaranteed. Secretary Regan then turned to Assistant Secretary Mulford, noting that Mulford had only just returned from a difficult negotiating session in Japan.

Dr. Mulford said that it was not a good time to change the debt strategy. He elaborated on the progress achieved in each of the five elements comprising the strategy and noted there were a number of important points that must be kept in mind in judging results thus far.

First, given the size of the problem and the difficulties in its resolution, there is a natural human tendency to seek universal and simple solutions. However, those close to the issue recognize this is not possible.

Second, the debt strategy always anticipated that resolution would take time. This reflects the incredible diversity among debtors, including the size of their problems, stage of adjustment, relations with the IMF, and whether adjustment is perceived as imposed or stemming from internal decisions.

He noted the different stages of adjustment of the four major Latin debtors -- Mexico, well down the road; Brazil, clearly committed; Argentina, beginning to recognize the need for adjustment and searching for necessary internal political agreement; and Venezuela, apparently unwilling to come to the IMF but having reserves and making some of the necessary adjustment decisions. Dr. Mulford indicated it was not realistic to look at across-the-board solutions such as interest rate caps or general changes in loan maturities to address such different cases. Consequently, we must utilize the strategy despite its frustrations, exceptions, and long time horizon.

Dr. Mulford believes the process of adjustment will take time and will involve continuous probing of limits -- countries experimenting with the acceptable pace of adjustment and the IMF defining the degree of flexibility that still permits attainment of its basic objectives. Commercial banks must also deal with the large number of participants, and difficult decisions to provide new money, particularly from smaller, more conservative banks. In the midst of these difficult ongoing processes, alternatives floated in the press by officials can have a tremendous effect on countries desperate for alternatives, with a negative impact on implementation of IMF programs.

Mr. Ernst agreed that the problems were diverse and that there is no easy solution, even as recovery spreads. An increasing problem will be that countries are becoming tired of austerity. In some cases, the foreign exchange constraint has been mitigated but domestic demand is not rebounding. The weakened private sector is not responding and this could stimulate overwhelming political pressure for increased government spending. Cites Brazil as possible example.

AID Administrator McPherson believed that while IMF programs are critical and that many necessary actions are being undertaken, the hard ones involving basic structural adjustment through the selling of parastatals to reduce the role of the public sector are not taking place. He believes that the Summit should discuss the need for increased Bank/Fund coordination to encourage such structural change. Secondly, McPherson urged focus not only on the debt problems threatening the system, but also politically-important countries such as Costa Rica, Sudan and Egypt. Secretary Regan noted that small countries continually ask the United States tc lean on the IMF. Treasury has refused and believes that the IMF is aware of political/social realities and adapts its programs appropriately. Moreover, we do not want the Bank to replace the IMF but come in behind it.

Under Secretary Wallis agreed that the strategy should not be changed but reported many at State were "nervous as hell" because of rising interest rates, the slow recovery in LDCs, and the fact that many adjustment reforms were not being implemented. He expressed concern about press stories on purported shifts in the U.S. strategy.

Assistant Secretary McCormack asked Secretary Regan his best guess on where interest rates would go in the next six months and how high they would have to go before a change was necessary in the strategy. Secretary Regan, quoting from a St. Louis Fed article, noted that the rise in rates during this recovery has been atypically high. He also noted that a majority of blue chip forecasters expect interest rates to peak by end 1985 between 12 and 14 percent. Dr. Mulford noted that a significant amount of debt was in non-U.S. currencies and that interest rates on dollar debt often moved with a lag, so the press may be overstating the actual impact on many countries of higher U.S. interest rates.

Under Secretary Olmer agreed on need to differentiate among borrowers and remains committed to strategy, but expressed view many thought five-point strategy was not a long-term solution. A Commerce Department analysis of trade and investment in Latin America had yielded very disturbing results. It suggested that recovery will not take place on the basis of export growth, that current account improvements resulted largely from import contraction, and that growth in exports is taking place in industries vulnerable to protection. He was struck, in recent meetings with the private sector in Brazil, that new jobs being created are a fraction of the increase in the labor force. He remains very worried about the impact on U.S. import and export industries.

Given the seriousness of the issue, he believes it reasonable to accelerate consideration of the strategy prior to the Summit. Mr. Olmer suggested that Dr. Mulford chair an interagency group to look at individual countries to reach judgments on the sustainability of their recovery. Secretary Regan indicated that Treasury officials would be traveling between now and the Summit, but would be happy to see Commerce's papers in the meantime.

Secretary Regan noted that some countries would only be saved by commodity price rises and asked Agriculture's view. Mr. Lyng said that a boom was not in store but that a commodity price rise was more important for the smaller countries. He agreed on need to stick to the strategy. In an aside, Secretary Regan marveled that we provide assistance to countries which can export more oil.

Roger Robinson noted that we must remember that the debt strategy is not just ours. He believes the Summit should reiterate support for the five-point strategy and express cautious optimism about the future. However, given the attention in the press, velocity of discussion, and interest rate rises, he wondered whether we are ready should the debt strategy become a major topic at the Summit.

The CEA representative said they still support the strategy although they note the risks and believe the Administration should look at various trade finance, interest rate cap proposals. He strongly supported an IG review.

Secretary Regan indicated we should differentiate between debtors which have, and have not, gone to the IMF. Perhaps caps would apply only to those who are in the adjustment process. He emphasized that any study must not be reported publicly, but should be done quietly after the Summit, within the SIG agencies. Dr. Mulford agreed that a follow-up IG study after the Summit would be a useful exercise, but that we should not discourage the banks from their own discussion of these issues.